DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 00-0148
Sales Tax
For Tax Periods 1996-1998

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ISSUE

I. Sales Tax—Service Plans

Authority: Covington Pike Toyota, Inc. v. Cardwell, 829 S.W.2d 132 (Tenn. 1992); IC 6-2.5-4-1; 45 IAC 2.2-4-2; 45 IAC 15-3-2; Information Bulletin # 2; Information Bulletin #15

Taxpayer protests imposition of sales tax on service plans sold to its customers.

II. Sales Tax—Capital Cost Reduction on Leased Vehicles

Authority: Meridian Mortgage Company, Inc. v. State, 395 N.E.2d 433 (Ind. App. 1979); City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind.Tax 1998); IC 6-2.5-1-5; IC 6-2.5-1-6; IC 6-2.5-5-38.2; IC 6-8.1-3-3; Attorney General Official Opinion No. 90-21

Taxpayer protests imposition of sales tax on Capital Cost Reductions on Leased Vehicles.

STATEMENT OF FACTS

Taxpayer operates three automobile dealerships in Indiana. The Department of Revenue ("Department") conducted an audit for the years 1996 through 1998. As a result of this audit, the Department issued Sales Tax assessments against taxpayer. Taxpayer protests two of the items assessed.

I. Sales Tax—Service Plans

DISCUSSION

Taxpayer protests the imposition of Sales Tax on certain service plans it sells to its customers. The Department imposed Sales Tax on the basis that these service plans call for the definite transfer of personal property. The Department did not impose Sales Tax on service plans that did not call for the definite transfer of personal property. Taxpayer does not believe that the taxed service plans represent the sale of tangible personal property, but rather the transfer of intangible personal property.

Taxpayer refers to IC 6-2.5-4-1(b), which states:

> A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:
>
> (1) acquires tangible personal property for the purpose of resale; and
> (2) transfers that property to another person for consideration.

Taxpayer believes that the service plans are contract rights transferred to the customer, and that these contract rights represent a form of intangible property not tangible personal property as required by the above-referenced regulation. Taxpayer states that it is therefore not engaged in selling at retail and so should not collect sales tax on the service plans.

The Department believes that taxpayer is engaged in selling at retail, as evidenced by the service plans that provide for the definite transfer of tangible personal property. The Department refers to IC 6-2.5-4-1(c), which states:

> For purposes of determining what constitutes selling at retail, it does not matter whether:
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> (1) the property is transferred in the same form as when it was acquired;
> (2) the property is transferred alone or in conjunction with other property or services; or
> (3) the property is transferred conditionally or otherwise.

Taxpayer states in its protest letter, "It is also important to recognize that, when selling a Service Plan, the Taxpayer has not obligated itself to supply tangible personal property or anything else to the customer." The taxpayer is selling the service plans. The fact that the service plans are agreements between the manufacturer and the customer are not determinative. Whether or not the service plans provide for the definite transfer of tangible personal property is the determinative issue.

Taxpayer offers several scenarios in which the customer would not have service performed at taxpayer's dealerships, and therefore not receive tangible personal property from taxpayer. Among these scenarios are: The customer may have the service done at another dealership for this make of car; if a car is wrecked, coverage under the service plan is terminated; the customer may intentionally or unintentionally skip scheduled maintenance. Taxpayer believes that, for these and other reasons, there is no certainty that taxpayer will ever provide any services or furnish any parts to a particular customer when a service plan is sold.

Taxpayer asserts that the service plans at issue embody a promise from the auto manufacturer to cover the costs of scheduled maintenance and repairs. Taxpayer offers the analogy of gift certificates to explain why it believes the service plans are not taxable. Taxpayer believes that sales tax should apply only to the sale of tangible personal property as it is supplied with routine maintenance.

Taxpayer explains that the service plans are exempt from Sales Tax according to Information Bulletin #2, which covers the subject of "Warranties and Maintenance Contracts". Information Bulletin #2 states in part:

> Optional extended warranties and maintenance agreements are offered as a separate added amount to the purchase price of property being sold and a fixed sum is charged for the furnishing of tangible personal property throughout the term of the warranty or the agreement. Optional warranties and maintenance agreements are not subject to sales or use tax. Optional warranties and maintenance agreements are not subject to tax because the purchase of the warranty or maintenance agreement is the purchase of an intangible right to have property supplied and there is no certainty that property will be supplied. However, if the agreement includes a charge for property to be periodically supplied, the agreement would be subject to tax.

Taxpayer also refers to Examples 4 and 5 in Information Bulletin #2, which state:

> 4. A computer software company sells a taxable software package to a customer for $2,000. The customer also purchases a maintenance agreement from the company. The customer did not have to buy the maintenance agreement. The agreement entitles the customer to up to twenty hours of programmer help to deal with any problems the customer might have in using the software package. The maintenance agreement is an optional maintenance and is not subject to sales tax.
>
> 5. Same facts as in Example 4, but the maintenance agreement also entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is subject to sales tax because

> it is a certainty that tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement.

Taxpayer believes that the auditors refused to apply Information Bulletin #2 to the service plans at issue. The audit report states that it is definite that tangible personal property will be transferred to the customer, while taxpayer contends that it is not definite that tangible personal property will be transferred.

The service plan contains a section titled, "WHAT THIS AGREEMENT COVERS". Subsection B of that section states:

> WE will pay the COST to perform scheduled maintenance services for those items listed in YOUR [Manufacturer] Owner's Handbook. Oil changes can be performed every three (3) months or 3,000 miles, or every six (6) months or 6,000 miles, whichever best describes the driving conditions of YOUR VEHICLE. This coverage applies only if the services are performed at a [Manufacturer] Retailer or [Manufacturer] Authorized Repair Facility and at the time/mileage intervals stated in the [Manufacturer] Maintenance Schedule. (Manufacturer's name omitted.)

The service plan provides for the definite transfer of tangible personal property in the form of motor oil and filters associated with oil changes. Even if the customer does not drive the car enough to meet the mileage trigger of 3,000 miles, the customer is entitled to a minimum of two oil changes every year under the six-month trigger. Additionally, the service plan also has a section titled, "CLAIM PROCEDURES", which states in part:

> If a FAILURE occurs, YOU must:
> 1) Use reasonable means to protect the covered VEHICLE from additional damage.
> 2) Contact the [Manufacturer] Retail from whom YOU purchased this AGREEMENT, or any other [Manufacturer] Retailer or [Manufacturer] Authorized Repair Facility; and
> 3) Obtain prior authorization from US before any work is done on the covered VEHICLE. If necessary, YOU must provide any information WE may reasonably require, including proof of required maintenance, and allow US to inspect the VEHICLE before WE authorize any repair. (Manufacturer's name omitted.)

The customer's coverage under the service plan is dependent on the customer complying with the maintenance schedule. Therefore, in order for the service plan to remain in effect, regular maintenance must be performed. The service plans compel the customer to perform regular maintenance or face having the plans invalidated.

In Example 5 of Information Bulletin #2, the maintenance agreement entitles the customer to four program updates per year. The program updates are available to all of the company's customers who purchased the software package. The maintenance is

subject to sales tax because it is a certainty that the tangible personal property, the updates, will be given to the customer under the terms of the maintenance agreement. The service plan at issue in this case entitles the customer to a minimum of two oil changes per year under the six-month trigger.

Taxpayer has put forth the possibility that the customer may not have the maintenance performed at the dealership that sells the plan. This is not the determining factor. The plan is an agreement between the manufacturer and the customer. The sale takes place in Indiana. The sales tax should be collected in Indiana. Taxpayer puts forth the possibility that the customer will never have the maintenance performed at all. It is sufficient that the service plan entitles the customer to the maintenance for the plan to be taxable.

Taxpayer offers the analogy of gift certificates to explain why it believes the service plans should not be taxed. Taxpayer states that the Department has ruled that the purchaser of gift certificates acquires the intangible right to purchase tangible personal property in the future, and that sales tax would only apply if and when the customer actually uses the gift certificate to purchase tangible personal property. Taxpayer believes that, in a similar fashion, the service plans provide the customer with the opportunity to acquire parts and labor in the future, if and when the customer has the car serviced.

There is a difference, however, between gift certificates and the service plans at issue. The gift certificates may or may not be used to purchase tangible personal property. Also, sales tax will be collected when the gift certificates are utilized for the purchase of tangible personal property. The service plans definitely entitle the customer to a minimum of two oil changes per year. As previously established, it does not matter if the customer has the oil changes performed. The fact that the customer is entitled to the tangible personal property associated with the oil changes is sufficient to make the service plans taxable.

Taxpayer refers to Information Bulletin #15, which covers the subject of "Application of Indiana Retail Sales Tax to Sales of Gasoline, Gasohol and Special Fuels Sold Through Stationary Metered Pumps". Section IX of Information Bulletin #15, covering "Service states:

A. Labor charges separately stated on repair orders are not subject to sales tax. (Sales tax must be collected on any parts used unless the purchaser issues an exemption certificate certifying exempt use.
B. Charges for washes, lubrications, polishing and waxing are not subject to sales tax. (The service station must pay sales tax on the purchase of any supplies consumed.)

Taxpayer explains that the auditors are imposing sales tax on one hundred percent (100%) of the purchase price of the service plans, thus imposing sales tax on all the parts and labor. Taxpayer states that if the customer had simply purchased scheduled maintenance services as needed, the tax would have been applied only on the parts

supplied, then poses the question, "Why the tax burden should be higher when the scheduled maintenance is provided pursuant to an optional Service Plan?". The reason, as explained in Section IX of Information Bulletin #15, is that the service plans do not separately state labor charges.

Taxpayer states that the Department's position is inconsistent with the decisions of courts in other states. The Department is not subject to the courts of other states, as provided in 45 IAC 15-3-2(b), which states:

> An interpretation of the statutory provisions governing the listed taxes, made by a court of competent jurisdiction, which conflicts with rules promulgated by the department, will render that rule, or portion of a rule, null and void, and will become the official interpretation of the department, effective upon the date of issuance of the court's decision. If such decision is appealed by the department, the interpretation will become effective when such decision becomes final.

The courts of any state other than Indiana are not courts of competent jurisdiction over the Indiana Department of State Revenue. Therefore the Department is not subject to decisions issued by courts in other states.

In addition to the fact that the case cited by taxpayer is not binding on the Department, which it is not, it is not relevant. Taxpayer cites Covington Pike Toyota, Inc. v. Cardwell, 829 S.W.2d 132, 135 (Tenn. 1992), where that court states:

> The words "performing" and "installing," taken in their natural and ordinary sense, mean the carrying out of physical acts. Performing repair services does not include the act of entering into a contractual commitment to provide in the future and on a contingent basis repair services. Under the statute, "[t]he taxable event is the rendering of repair services in Tennessee," LeTourneau Sales & Serv., Inc. v. Olsen, 691 S.W.2d 531, 536 (Tenn. 1985), not the future and uncertain prospect of having repair services performed in Tennessee. The taxable activity described in § 67-6-102(22)(F)(iv) is a physical activity performed with respect to tangible personal property, and does not include the undertaking of a contractual commitment whereby such services may, or may not, be provided in the future.

The warranties at issue in Covington Pike Toyota were for repair services. There was no certainty that the cars would need repairs in that case. The Department has already agreed that the service plans sold by taxpayer in the instant case which provide solely for repair and not for maintenance are not subject to sales tax. The service plans at issue in this protest are for repair and maintenance services. There is a certainty that the customers who purchase the service plans in this instance will be entitled to a minimum of two oil changes per year under the six-month trigger.

Taxpayer states that the tangible personal property supplied to customers under the service plans account for less than ten percent (10%) of the total sale price, and are therefore not subject to sales tax under 45 IAC 2.2-4-2(a). That regulation states:

> Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:
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> (1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;
> (2) The tangible personal property purchased is used or consumed as a necessary incident to the service;
> (3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and
> (4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

There are four steps that must be satisfied in order for sales tax to not apply under this regulation. Taxpayer has submitted no documentation establishing that: 1) it is engaged in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property; 2) the tangible personal property purchased is used or consumed as a necessary incident to the service; 3) the price charged for tangible personal property is ten percent or less compared with service charges; or 4) that it pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. Therefore, none of the four steps have been satisfied, let alone all four as required in order for this regulation to apply.

In conclusion, the service plans entitle the customer to a minimum of two oil changes per year and therefore provide for the definite transfer of tangible personal property. As explained in Example 5 of Information Bulletin #2, an optional maintenance agreement is taxable when it entitles a customer to tangible personal property.

FINDING

Taxpayer's protest is denied.

II. **Sales Tax—Capital Cost Reduction on Leased Vehicles**

DISCUSSION

Taxpayer protests imposition of Sales Tax on the Capital Cost Reduction on Leased Vehicles ("Reductions"). The Department imposed Sales Tax on the reductions for the period from July 1, 1995 to June 30, 1997. Taxpayer believes that the reductions are not taxable for several reasons.

Taxpayer does not agree that the exchange of a customer-owned vehicle for a leased vehicle falls outside the definition of a "like kind exchange" in IC 6-2.5-1-5 and IC 6-2.5-1-6. IC 6-2.5-1-5 states in relevant part:

> (a) "Gross retail income" means the total gross receipts, of any kind or character, received in a retail transaction, except that part of the gross receipts attributable to:
>
> (1) the value of any tangible personal property received in a like kind exchange in the retail transaction;

IC 6-2.5-1-6 states:

> (a) "Like kind exchange" means the reciprocal exchange of personal property between two (2) persons, when:
>
> (1) the property exchanged is of the same kind or character regardless of grade or quality; and
> (2) the persons exchanging the property both own the property prior to the exchange.
>
> (b) A "like kind exchange" may be part of a transaction involving additional consideration other than the exchanged property.
> (c) Notwithstanding subsection (a), a "like kind exchange" does not occur when:
>
> (1) the transaction involves more than two (2) persons; or
> (2) one (1) party to the transaction, through agreement or negotiation with the second party, acquires personal property for the primary purpose of exchanging that property for like kind property held by the second party.

Taxpayer believes that the owned car exchanged for the leased car is an exchange of like kind tangible personal property.

As explained in Meridian Mortgage Company, Inc. v. State, 395 N.E.2d 433, 439 (Ind. App. 1979), "The three primary indicia of ownership of personal property are Title;

possession; and Control, which includes the right to sell, dispose of, or transfer." A renter does not have these rights, therefore, the Department considers the bundle of rights associated with ownership as different from the bundle of rights associated with rental. Since the rights associated with an owned car and those associated with a rented car are not the same, the Department did not consider the trade of an owned car for a rented car a like kind exchange.

Taxpayer points out that by not taxing trade-ins on or after July 1, 1997, the Department is acknowledging IC 6-2.5-5-38.2, which states:

> The value of an owned vehicle is exempt from the Indiana gross retail tax in a vehicle lease transaction if the owned vehicle is exchanged for a like kind exchange.

The Department notes that absent language stating otherwise, statutes are given prospective treatment. In this instance, the wording of Public Law 253 Section 38 - the law in which IC 6-2.5-5-38.2 was enacted – explicitly states that this new section was to take effect on July 1, 1997. Therefore, the Department can not apply this statute retroactively.

Taxpayer argues that the Department did not take the necessary steps to change its interpretation of the applicable statutes. Taxpayer states that by recognizing the exclusion from sales tax before July 1, 1995, but taxing such transactions after that date, the Department has clearly changed its interpretation of the applicable statutes. Taxpayer refers to IC 6-8.1-3-3(b), which states:

> No change in the department's interpretation of a listed tax may take effect before the date the change is:
>
> (1) adopted in a rule under this section; or
> (2) published in the Indiana Register under IC 4-22-7-7(a)(5), if IC 4-22-2 does not require the interpretation to be adopted as a rule;
>
> if the change would increase a taxpayer's liability for a listed tax.

The Department issued an advisory letter, dated April 25, 1995, to the Indiana Automobile Dealer's Association, which explained the Department's position regarding the Reductions. The letter explained the Department's reliance on 45 IAC 2.2-1-1(j), which states that there is a taxable event when any property is used as a medium of exchange in lieu of cash. In taxpayer's case, the customer trades property, the used car, in lieu of cash for the lease on the new vehicle. The letter also explained that the automobile dealers should collect sales tax on the reductions starting July 1, 1995.

Taxpayer's position is that the advisory letter does not satisfy IC 6-8.1-3-3(b), because taxpayer views it as a change in the Department's interpretation of a listed tax. The

advisory letter was not a change in the Department's interpretation of 45 IAC 2.2-1-1(j). The Department issued the letter to make automobile dealers aware of the regulation and to allow them time to begin collection of the sales tax. The Department never recognized the exclusion from sales tax for trade-ins, as taxpayer asserts. The Department always interpreted the use of property as a medium of exchange in lieu of cash as a taxable event. Therefore, there was no change in interpretation, and so IC 6-8.1-3-3(b) does not apply.

Taxpayer next raises Attorney General Official Opinion No. 90-21. That opinion concerns the Department's desire to impose gross income tax on cable television franchise fees. The Attorney General determined that legislative change was required before the Department could subject cable television franchise fees received from a private cable television operator by a political subdivision to Indiana Gross Income Tax. The Attorney General's opinion was based on the fact that Indiana Department of Revenue rules listed examples of activities that would subject a political subdivision to Gross Income Tax, and cable television franchise fees was not listed.

The Attorney General concluded that if the Department would start taxing those fees, it would constitute a change in the Department's interpretation of a listed tax. For the reasons previously discussed, the Department in the instant case did not change its interpretation of a listed tax. Therefore, Attorney General Official Opinion No. 90-21 does not apply here.

Next, taxpayer raises City Securities Corp. v. Indiana Department of State Revenue, 704 N.E.2d 1122 (Ind. Tax 1998). Taxpayer states that the Court in that case held that the Department was prohibited from changing an interpretation without adopting a regulation. Again, for the reasons previously discussed, the Department has not changed its interpretation of a listed tax. Therefore, the opinion in City Securities does not apply here.

In conclusion, the Department properly taxed the capital cost reductions on leased vehicles for the time included in this audit. The Department can not retroactively apply IC 6-2.5-5-38.2. The Department did not change its interpretation of a listed tax and therefore did not need to promulgate a new regulation.

FINDING

Taxpayer's protest is denied.

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